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IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

No.....

R. A. BABCOCK and NORMA L. BABCOCK, *Petitioners,*

v.

V. LEE PHILLIPS, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

Petitioners, R. A. Babcock and Norma L. Babcock, pray that a writ of certiorari issue to review the opinion and judgment of the United States Court of Appeals for the Tenth Circuit, entered in the above entitled case on January 27, 1967, which affirmed the judgment of the United States District Court for the District of Colorado.

CITATION TO OPINIONS BELOW

The opinion of the District Court is not yet reported in the Federal Supplement, and is printed at pages 16-20 of the Transcript of Record filed in the Court of Appeals. The opinion of the Court of Appeals, printed in Appendix A, infra, is not yet reported in Fed. 2d.

JURISDICTION

Jurisdiction of this Court is involked under 28 U.S.C. Sec. 1254(1).

QUESTIONS PRESENTED

1. Where stockholders of a State Bank obtained a national banking charter and formed a National Bank with independent risk capital, with National Bank leasing the banking building, furniture and equipment and hiring the employees of State Bank, excepting its president, and engaging in business at the same location of State Bank; where State Bank, in liquidation, paid its depositors' liability by placing sufficient cash and securities with National Bank in trust for its depositors and later distributed all its cash, realty, furniture and equipment to its stockholders and dissolved, was there a reorganization of State Bank under section 368(a)(1)(D), rather than a complete liquidation under section 331, of the Internal Revenue Code? We submit the Circuit Court's conclusion that there was a D reorganization of State Bank is untenable.

A. Whether the Court correctly concluded as a matter of law that National Bank acquired "substantially all of the assets" of State Bank, which is one of the requirements for a D reorganization? The Court of Appeals conclusion is not supported by the facts and is in conflict with Rev. Proc. 66-34, I.R.B: 1966-34.

B. Whether the Court erred in not passing upon the question of whether the capital stock of National Bank was distributed and exchanged for stock of State Bank in pursuance to a plan of reorganization? We submit the Circuit Court erred in not deciding this express statutory requirement for a D reorganization.

C. Whether the Circuit Court erroneously concluded the liquidation resulted in a reincarnation of State Bank as National Bank and, because the taxpayer-stockholder was not disassociated from National Bank, a D reorganization occurred, resulting in the liquidation distributions being taxable as ordinary "boot" income? The holding of the Court of Appeals is in direct conflict with *United States v. Arcade Co. et al.* (CA-6, 1953) 203 F. 2d 230; *Prudemark, Inc. et al v. C.I.R.* (CA-4, 1965) 345 F. 2d 35; *C.I.R. v. Hyman H. Berghash, et ux* (CA-2, 1966) 361 F. 2d 257 aff'g 43 T. C. 743; *Joseph C. Gallagher, et al* (1962) 39 T. C. 144 (Rev'd by Court, three dissents), Appeal dismissed CA-9, 9/23/63.

2. Whether the Circuit Court erroneously placed in issue the business purpose test and, by innuendo, deciding there was a lack of a business purpose for the liquidation of State Bank? The placing of the business purpose test in issue by the Court of Appeals and its conclusions thereon is clearly erroneous and is in direct conflict with *General Utilities & Operating Co. v. Helvering* (1935) 296 U. S. 200.

STATUTES INVOLVED

The applicable statutes are Chapter 14, Article 13, Section 81 of the Colorado Banking Code of 1957; and section 301, 302, 316, 331, 354, 356 and 368 of the Internal Revenue Code of 1954. These statutes are set forth in Appendix B hereto.

STATEMENT

The evidentiary facts are not in dispute. In 1954 R. A. Babcock[1] became the owner of 800 shares of the capital stock of First State Bank of Walsenburg.[2] The president of State Bank owned the remaining 200 shares. State Bank was losing business to national banks and the Walsenburg community wanted a national bank. State Bank was greatly overcapitalized, the Colorado Banking Department wouldn't permit a reduction of its capital, and the only way to reduce the capital was to liquidate. The stockhold-

[1] The wife is involved because of filing joint income tax returns.
[2] Herein referred to as State Bank

ers of State Bank wanted a more profitable bank for Walsenburg, Colorado, and in December 1957, the Comptroller of the Currency preliminarily approved their application for a national banking charter at Walsenburg. On Jahuay 13, 1958, Babcock purchased the president's 200 shares of State Bank stock and immediately sold 150 shares to five other individuals. On January 14, 1958 the stockholders adopted a plan to liquidate State Bank.

On January 14, 1958 the stockholders of State Bank contributed and paid in cash of $250,000 for the capital stock of First National Bank in Walsenburg[3], with Babcock owning 85% of the stock. On January 23, 1958 National Bank was granted its charter; on January 25, 1958 it leased the banking building, furniture and equipment and hired the employees of State Bank, excepting its president, and commenced business as a national Bank.

The first step in the liquidation of State Bank required by the Colorado Statutes was to pay the depositors' liability. This was accomplished by State Bank escrowing $3,827,254.76 with National Bank in trust for the depositors. Within several months after Nat'l Bank had commenced business the depositors of State Bank deposited their said trust amounts in National Bank. During the latter part of the year 1958, under authorization by the Colorado Banking Department, State Bank distributed to its stockholders all its assets, consisting of $476,388.80 cash, realty, furniture and equipment (including the building, furniture and equipment under lease to National Bank). The banking charter of State Bank was cancelled and State Bank was dissolved on January 5, 1959.

The taxpayer reqlized gains of $83,450 in his FYE 8/31/58 and $63,388.80 in his FYE 8/31/59, represented by the excess of his liquidating distributions over the cost basis of his cancelled State Bank stock. The District Director of Internal Revenue contended there was a reorganization of State Bank under sec. 368(a)(1)(B), (D) or (F), with the resulting distributions to Babcock being taxable as ordinary dividend income under sec. 356. The District Director has abandoned or conceded his conten-

[3] Herein referred to as National Bank

tion for a B or F reorganization. Petitioners contend there was a complete liquidation of State Bank with the resulting gains to Babcock being taxable as capital gains. The District Court found that "most of the assets of State Bank were liquidated" but then concluded that substantially all of the assets of State Bank were acquired by National Bank within the meaning of sec. 354 and that a D reorganization occurred. The Circuit Court affirmed, apparently upon the basis of its placing the business purpose test in issue. The approach of the Circuit Court is best illutrated by the following extract from its opinion:

"The conclusion of the trial court relative to the reorganization plan is based on the finding of the court 'that National Bank acquired "substantially all of the assets" of State Bank within the meaning of Title 26 U. S. C., Section 354(b)(1)(a).'

This finding qualified the transaction as a reorganization under 368(a)(1)(D) and made section 356 the 'boot' section applicable to section 354 situation.

The liquidation resulted in a reincarnation of the State Bank as National. The taxpayer was not disassociated from the new corporation which resumed the business as a going concern.

Therefore, the appellant was properly assessed for the 'boot' he received out of the transaction viewed in the light of the purpose which he sought to accomplish."

REASONS FOR GRANTING THE WRIT

1. *D Reorganization Requirements*

Petitioners contend the liquidation of State Bank fails to qualify as a D reorganization under sec. 368(a)(1)(D) and its modifying sec. 354(b)(1)(A) and (B) because both of the following questions can not be answered in the affirmative:

(a) Did National Bank acquire "substantially all of the assets" of State Bank?

(b) Was the capital stock of National Bank distributed in pursuance of a plan of reorganization?

A. National Bank didn't acquire substantially all of the assets of State Bank. National Bank commenced business in January, 1958 with a national banking charter and independent capital of $250,000 in cash. It leased the building, furniture and equipment of State Bank and it hired the employees of State Bank, excepting its president.

State Bank, in liquidation, escrowed cash and securities aggregating $3,827,254.76 with National Bank in trust for the depositors. These trust assets lost their identity as State Bank assets and became the property of and were beneficially owned by the depositors. It was the State Bank depositors who, some several months after National Bank had been in operation, deposited their funds, which were in the form of cash and securities, in National Bank. *Wall v. United States* (CA-4, 1947) 164 F. 2d 462. It was in the latter part of the year 1958 that the Colorado Banking Department, after having been satisfied the depositors had been paid, authorized State Bank to distribute to its stockholders all its assets consisting of cash, realty, furniture and equipment and to dissolve.

The District Court found that "most of the assets of State Bank were liquidated and there was distributed to the stockholders of State Bank between August and November 1958, $506,388.80 and in addition certain real estate, furniture, fixtures and equipment." The Circuit Court reiterated the District Court's erroneous conclusion "that National Bank acquired 'substantially all of the assets' of State Bank within the meaning of" sec. 354. Neither the District nor Circuit Courts gave any factual basis or grounds for the latter conclusion.

The "substantially all" conclusion by the Circuit Court is clearly erroneous. It also conflicts with Rev. Proc. 66-34, I. R. B. 1966-34, which would require a transfer by State Bank to National Bank of 90% of its net assets and 70% of its gross assets to satisfy the "substantially all" requirement of the statute.

B. We submit this Court should pass upon the question of whether the Circuit Court properly ignored the express statutory requirement for a D reorganization, namely, that the stock of National Bank be "distibuted in pursuance

of a plan of reorganization." The undisputed facts are that in January 1958, the taxpayer and several other individuals paid cash of $250,000 for the capital stock of National Bank, which was used to commence business. This risk capital was independent and unrelated to the capital or assets of State Bank. It was over seven months later, before the Colorado Banking Department permitted State Bank to distribute its cash and other assets to its stockholders. Clearly the capital stock of National Bank was issued for cash, and not distributed in pursuance of a plan of reorganization.

C. The Circuit Court, relying upon *Reef Corporation v. C. I. R.* (CA-5, 1966) 368 F. 2d 125 and *Davant v. C. I. R.* (CA-5, 1966) 366 F. 2d 874 (Cert. applied for in both cases), bases its conclusion that a D reorganization occurred on the grounds that (1) "The liquidation resulted in a reincarnation of the State Bank as National" and (2) "The taxpayer was not disassociated from the new corporation which resumed the business as a going concern." The Circuit Court's conclusion that National Bank was a reincarnation of State Bank conflicts with *First National Bank in Walsenburg v. C. I. R.*, T. C. Memo 1965-286, which held: "National is not liable as a transferee for State's federal income tax liabilities."

The Circuit Court's decision is in direct conflict with *United States v. Arcade Co. et al.* (CA-6, 1953) 203 F. 2d 230, which latter case was decided under sec. 112 G of the 1939 Internal Revenue Code, the corresponding section to 368(a)(1)(D), infra. In the Arcade case the Circuit Court, at page 235, rejected the government contention "that where transactions result in a new corporation which emerges and actually uses the transferred assets to continue the business with the same proprietary interests, such transactions amount to a reorganization." In the instant case the Circuit Court's decision sets forth standards and requirements for a D reorganization which are not expressly proscribed in the statutory definition of a D reorganization.

The Circuit Court's decision here also conflicts with *Pridemark, Inc.* et al. v. C. I. R. (CA-4, 1965) 345 F. 2d 35, where the Fourth Circuit rejected the government's re-

incorporation and taxpayer-stockholder association doctrine as a basis for a D reorganization. In *Pridemark* the taxpayer-stockholder became associated with the new corporation.

In the thoroughly reasoned opinion of *Joseph C. Gallagher, et al* (1962) 39 T. C. 144 (Rev'd by court, three dissents) appeal dismissed (CA-9, 9/23/63), the Tax Court rejected the government's contention that a D reorganization occurred merely because the liquidation was followed by a reincorporation and the taxpayers were not disassociated from the new corporation. In *C. I. R. v. Hyman H. Berghash, et ux.* (CA-2, 1966) 361 F. 2d 257 Affg. 43 T. C. 743, the Second Circuit rejected the government's contention that a statutory reorganization occurred, rather than a complete liquidation, where the business of the liquidated corporation was continued by the new corporation and the taxpayer wasn't disassociated from the new corporation. The transaction in the Berghash case, like here, "was founded upon a bona fide business purpose."

2. *Business Purpose Test.*

The Circuit Court's failure to come to grips with the crucial question of whether substantially all of the assets of State Bank were transferred to National Bank is possibily based upon its inferential conclusion that there was an absence of business purpose in liquidating State Bank. Its opinion states, out of context, that the president of State Bank testified that "The primary reason for liquidation of State Bank was top-heavy capitalization." Then the Circuit Court concludes "the primary purpose of the transaction was to syphon off the excess capital of State Bank."

The said president of State Bank explained to the trial court the business purpose for remedying the overcapitalization condition and liquidation of State Bank as follows (R. 74):

"Q. And it was top-heavy capitalization. What does that mean?

A. Well, we had a lot of money invested for the return. If you put a thousand dollars into something and

draw forty dollars you get four per cent. If you put two thousand dollars in there and still draw only forty dollars, why, it makes a difference whether you want two thousand or one into the corporation.

Q. Well, did you have any discussions with Mr. Babcock how this overcapitalization would be remedied?

A. Yes, sir. I thought the thing to do was what was done, that they liquidate the bank and sold it out with the idea of saving on the taxes and reducing the capital. That's about the only way is to reduce the capital stock of a bank."

The taxpayer gave these reasons for starting National Bank (R. 48):

"Now, Mr. Babcock, I would like to have you tell us what the purpose or reasons there were for starting National Bank.

A. Well, we made an extensive survey down there, and we found that the community was more in accord with a national bank, and I felt it was more profitable to have a national bank than a state bank, and that's what brought it about, in getting a national charter down there. And I worked very hard to get it and it has proven out that I was slightly right.

Q. Did you try to sell State bank?

A. I did. In fact, I promised the people that I owed money to in Chicago that I would be able to sell it *within* a year.

Were you able to sell the bank?

A. No. I even called up Transamerica in California to see if they would be interested in the bank, and the first question this buyer asked me if it was a national or a state bank. He said, 'We aren't interested.' He says, 'We do have one or two state banks, but we are not interested in any more state banks.'

Q. Have you sold National Bank?

A. Yes."

On cross examination, the taxpayer gave these ad-

ditional reasons for starting National Bank (R. 70):

"Q. And did you form National Bank in order to improve your competitive position there in the County of Huerfano?

A. Yes, I think it did improve it.

Q. I didn't ask you what the result was. I asked you if one of the reasons for your forming the First National Bank in Walsenburg was because of competitive conditions in Huerfano County?

A. I think so, yes, sir. I will answer that yes.

Q. At the time of the change from a state bank to a national bank, did you assure the customers of the State Bank that they would be dealing with the same employees as they had been before?

A. I probably didn't because I wouldn't know how a person could do that. I don't think I ever told anybody that because we change employees in all of these banks from time to time."

It is submitted the evidentiary facts clearly establish a business purpose for the formation of National Bank and the liquidation of State Bank. Further, neither the pleadings nor the pre-trial order placed the business purpose test in issue. Government counsel never contended in the trial court there was any lack of a business purpose and, during oral argument in the Circuit Court, conceded the District Director wasn't claiming a lack of business purpose for the transactions.

We submit it was error for the Circuit Court to inject the question of business purpose and to "conclude the primary purpose of the transactions was to syphon off the excess capital of State Bank." *General Utilities & Operating Co. v. Helvering* (1935) 296 U. S. 200. If the Circuit Court's opinion is based upon lack of business purpose, then it is in direct conflict with the *General Utilities & Operating Co.* case.

CONCLUSION

We submit the opinion of the Court of Appeals is in direct conflict with the opinions of the Second, Fourth, Sixth and Ninth Circuits as above outlined. The pending petitions for certorari in the Davant and Reef Corporation cases is illustrative of the importance of the D reorganization questions here involved.

For the foregoing reasons petitioners respectfully pray that their petition for writ of certiorari be granted.

Respectfully submitted,

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APPENDIX A

United States Court of Appeals
Tenth Circuit

November Term - 1966

R. A. BABCOCK and NORMA BABCOCK,
Appellants,

v.

V. LEE PHILLIPS,
Appellee.

No. 8603

Appeal from the United States District Court
for the District of Colorado

GENE W. REARDON, Denver, Colorado, for appellants.

DONALD W. WILLIAMSON, JR., Attorney, Dept. of Justice, Washington, D.C. (Lawrence M. Henry, U. S. Atty., David I. Shedroff, Ass't. U.S. Atty., Mitchell Rogovin, Ass't Attorney General, Lee A. Jackson, Atty. Dept. of Justice and Harry Baum, Atty. Dept. of Justice, on the brief) for appellee.

Before MURRAH, Chief Judge, HILL and HICKEY, Circuit Judges.

HICKEY, Circuit Judge.

The sole issue to be determined on this review is whether funds distributed to appellants [1] were taxable as ordinary income or as long term capital gain. The trial court determined that the transactions which made the distribution available constituted a corporate reorganization which did not qualify all of the distribution for capital gain treatment. The appellants contend the distribution was made pursuant to a complete liquidation of a corporation and it should, therefore, be taxed as long term capital gain under Section 331 of the Internal Revenue Code of 1954.[2] The facts are not in dispute.

[1] The wife is a party to the action only because she and her husband filed joint returns for the years involved.

[2] 26 U.S.C. §331.

Appellants, taxpayer, purchased 800 shares of the First State Bank of Walsenburg [3] stock in 1954 for $255,800.00. The remaining 200 shares were owned by the President of the bank.

In December of 1957 the Comptroller of Currency granted conditional approval for a National Bank in Walsenburg, Colorado.[4]

On January 13, 1958, appellant purchased the remaining 20 shares of State Bank's stock from the President for $100,000.00. One hundred fifty of these shares were immediately sold to five persons for the same price paid by the appellant.

On January 14, 1958, appellant and these five persons adopted a plan to incorporate National Bank. The parties payed $250.00 per share for the stock and each received the same proportionate number of shares as their interest in State Bank. Appellant received 85% of the stock and 15% was distributed to the remaining five persons. On the same day the same six persons adopted a plan of liquidation of State Bank whereby the fiduciary assets and liabilities were to be transferred to National Bank.

On January 23, 1958, the Comptroller of the Currency issued a charter for National Bank to commence buisness, and on January 25, 1958, pursuant to an agreement between the two banks, all the fiduciary assets and liabilities were transferred to National Bank in trust for the depositors of State Bank for such time as it required the depositors to affirm the transfer. The officers and employees of State Bank became the management of National; the business continued at the same location pursuant to a gratuitous lease covering the bank building; and all the furniture, fixtures and equipment continued under the National name. Thereafter, in September 1958, the State Banking Department of Colorado authorized a partial distribution of the remaining assets of State Bank.[5]

Subsequently, in October of 1958, appellant repur-

[3] Hereinafter referred to as State Bank.
[4] Hereinafter referred to as National Bank
[5] Appellant owned 85% of the stock at that time.

chased the 150 shares held by the other five persons and became the sole stockholder of State Bank.[6]

On November 3 and 30, 1958, the final distributions were authorized by the State Banking Department. Appellant was sole stockholder at this time. Taxes were paid by appellant, claims for refund filed and this action commenced when the claims were refused.

Caldwell, former President of the State Bank, who did not participate in the transaction included in the plan, testified, "The primary reason for liquidation of State Bank was top-heavy capitalization."

The primary reason thus established compels us to examine the transactions stripped of their technical niceties. The steps were: acquisition of a National charter; incorporation of a National Bank with the same stockholders owning the same amounts of stock they owned in State; the transfer of State's fiduciary assets to National; the operation of the banking business by National at the same place, with the same officers, employees and stockholders, using the same equipment with only a change of name; the dissolution of State Bank; and the distribution of assets not required to continue operation.[7]

Considering the uncontradicted evidence recited above, we conclude the primary purpose of the transactions was to syphon off the excess capital of State Bank.

The transaction evolved a mere incarnation of a prior corporation. "Transactions whereby the interests of two or more corporations become identified are susceptible of arrangement into four general groups . . . The third type of combinations comprehends cases in which the new corporation is, neither in law or in point of fact, the reincar-

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[6] 130 of the shares were acquired for $3,250.00 in excess of the price for which appellant had originally sold them, and 20 shares were acquired for $8,360.00 less than the price for which appellant had sold them.

[7] State Bank was a safe, healthy and prosperous institution with loans, discounts, bonds, notes, bills and cash in the total amount of $3,827,254.76. These were transfererd to National Bank. Additional assets in the amount of $506,388.80 together with certain real estate, furniture, fixtures and equipment were liquidated and distributed to the stockholders of State Bank.

nation or reorganization of one previously existing." 19 Am. Jur. 2d Corporations, §1491 at 873, 874.

Under absolute similar reincorporation transactions it was held "The law seems to be well settled that, where a corporation is the mere incarnation of a prior corporation, the new corporation must answer for all of the obligations of the old. [Citations omitted]." McCarthy v. Liberty National Bank, 175 Pac. 940; 7 ALR 139. Therefore, it is irrelevant to the tax consequences that State Bank placed cash and securities in escrow with National Bank for the purported purpose of protecting its depositors.

Having determined the purpose to be accomplished, and having examined the vehicle utilized, we turn to the threshold issue of the tax consequences.

The substance rather than the form of the transaction is the controlling consideration. Gregory v. Helvering, 293 U.S. 465 (1935); Prairie Oil &Gase Co. v. Motter, 66 F. 2d 309 (10 Cir. 1933).

> "In order to effectuate the intent of Congress the dividend, liquidation, redemption and reorganization sections of the Code must be examined and viewed as a functional whole. The basic framework by which Congress sought to tax corporation distributions is contained in section 301(a), 301(c) and 316. Distributions of corporate funds to stockholders made with respect to their stockholdings must be included in their gross income to the extent that those distributions are made out of the corporation's earnings and profits. Such distributions are termed by the Code as dividends and are taxed as ordinary income." Davant v. Commissioner of Internal Revenue, 366 F. 2d 874, 879 (5 Cir. 1966).

> "In Helvering v. Alabama Asphaltic Limestone Co., 315 U.S. 179, 62 S. Ct. 540, 86 L.Ed 775 (1942), the Supreme Court affirmed an appeal from this Circuit in which this Court had held that a series of events must be construed as a single transaction coming within the reorganization provisions, even though they did not meet its literal language. The Supreme Court said [Citation omitted] 'The separate steps were integrated

parts of a single scheme. Transitory phases of an arrangement frequently are disregarded under these sections of the revenue acts. [i.e., the liquidation and reorganization provisions] where they add nothing of substance to the completed affair. [Citations omitted]. Here they were no more than intermediate procedural devices utilized to enable the new corporation to acquire all the assets of the old one pursuant to a single reorganization plan.' . . .

Congress has attempted to provide for taxing the siphoning off of liquid assets in the course of a reorganization." Davant v. Commissioner of Internal Revenue, 366 F. 2d 874, 883, 885.

The trial court, adopting the determinations of the Commissioner of Internal Revenue, found that appellant realized by the liquidation distribution $83,450.00 in the taxable year 1958 and $63,388.80 in the taxable year 1959 in excess of the basis of his State Bank stock. The court determined that these gains constituted ordinary income. It seems certain that

'. . . despite the declaration of a 'liquidating dividend' followed by the transfers of legal title, . . . these were mere formalities designed 'to make the transaction appear to be other than what it was' in order to avoid tax liability. . . .

To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress." Commissioner of Internal Revenue v. Court Holding Co., 324 U.S. 331, 333, 334 (1945).

The liquidation in the present case was the step in the series of transactions by which the purpose of reducing capital was accomplished.

"The code provides no definition of 'complete liquidation.' We reject the simplistic argument of the taxpayer that the phrase refers only to the measures required by state law to terminate a corporation's legal existence. No reason is offered as to why the observ-

ance of such mechanical procedures would prompt Congress to treat as stock redemptions payments that are in reality dividends. A more convincing indication of what distributions are meant to be accorded favored treatment is found in an early report of the Senate Finance Committee. S. Rep. No. 398, 68th Cong., 1st Sess. 12 (1924) There a distribution in complete liquidation was analogized to a sale of stock in that the shareholder 'surrenders his interest in the corporation and receives money in place thereof.' The corporation must have ceased to be a going corporate concern, or if the enterprise is continued in corporate form, the shareholder must have disassociated himself from it. [Citation omitted]. If the liquidated business is not resumed by the new corporation as a continuation of a going concern, there is a 'complete liquidation.'" Pridemark, Inc. v. Commissioner of Internal Revenue, 345 F. 2d 35, 41 (4 Cir. 1965).

The taxpayer did not disassociate himself from the banking business, but retained an 85% interest in the reincarnated National Bank. The mere fact that taxpayer made a separate purchase of National's shares does not alter this fact. His 85% interest in the fiduciary assets of State Bank continued after they had been transferred to National Bank which was the continuation of a going concern. The purchase of stock merely added additional value to the corpus of the National's corporate assets.

The reincarnation of State as National, the trial court concluded, "constituted a reorganization within the meaning of Title 26 USC, Section 368(a)(1)(D)."

"The (D) reorganization provisions have never been confined to a strictly literal application." Davant v. Commissioner of Internal Revenue, 366 F. 2d 874, 884.

"In general the reorganization sections of the Code, §§351 through 381, are designed to permit certain corporate changes and adjustments to be made without tax consequences to the participating corporation or corporations or their shareholders. The congressional policy is that while such transactions may

produce changes in the conduct of the business enterprise or in ownership, these changes are not sufficiently significant to warrant taxing the gain or allowing the loss which comes about by reason of the chance . . .

But this is not the end of the matter. The statute also provides that pursuant to the plan of reorganization, . . . the stock or securities of the corporation to which the assets are transferred (new Reef) be distributed in a transaction which qualifies under §354, 355, or 356 of the Code. 26 USCA, §§354, 355, 356. Only §354 is pertinent here. Section 356 is the 'boot' section. applicable to either a §354 or a §355 situation." Reef Corp. v. Commissioner of Internal Revenue, ...F. 2d.... (5 Cir. Oct. 1966).

The conclusion of the trial court relative to the reorgnaiaztion plan is based on the finding of the court "that National Bank acquired 'substantially all of the assets' of State Bank within the meaning of Title 26 U.S.C., Section 354(b)(1)(a)."[8]

This finding qualified the transaction as a reorganization under 368(a)(1)(D) and made section 356[9] the "boot" section applicable to the section 354 situation.

The liquidation resulted in a reincarnation of the State Bank as National. The taxpayer was not disassociated from the new corporation which resumed the business as a going concern.

Therefore, the appellant was properly assessed for the "boot" he received out of the transaction viewed in the light of the purpose which he sought to accomplish.

AFFIRMED.

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[8] Title 26, USC §354(b)(1) provides: "Subsection (a) shall not apply to an exchange in pursuance of a plan of reorganization within the meaning of section 368(a)(1)(d), unless (A) the corporation to which the assets are transferred acquires substantially all of the assets of the transferor of such assets; . . ."

[9] 26 USC §356(a) provide: "(a) Gain on exchanges — (1) Recognition of gain. — If — (A) section 354 or 355 would apply to an exchange but for the fact that (B) the property received in the exchange consists not only of property permitted by section 354 or 355 to be received without the recognition of gain but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property."

JUDGMENT

Eighteenth Day, January Term, Friday, January 27th, 1967.

Before Honorable Alfred P. Murrah, Chief Judge, and Honorable Delmas C. Hill and Honorable John J. Hickey, Circuit Judges.

This cause came on to be heard on the transcript of the record from the United States District Court for the District of Colorado and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said district court in this cause be and the same is hereby affirmed.

APPENDIX B

Colorado Banking Code of 1957, Chapter 14, Article 13, (Session Laws of Colorado, 1957, Chapter 86, Title 4)

TITLE 4. LIQUIDATION, DISSOLUTION AND REORGANIZATION

14-13-81. Voluntary liquidation and dissolution — (1) With the approval of the banking board, a state bank may liquidate and dissolve. The banking board shall grant such approval if it appears that:

(a) The proposal to liquidate and dissolve has been approved by a vote of two-thirds of the outstanding voting stock at a meeting called for that purpose.

(b) The state bank is solvent and has sufficient liquid assets to pay off depositors and creditors immediately.

(2) (a) Upon approval by the banking board, the bank shall forthwith cease to do business, shall have only the powers necessary to effect an orderly liquidation, and shall proceed to pay its depositors and creditors to wind up its affairs.

(b) Within thirty days of the approval, a notice of liquidation shall be sent by mail to each depositor, creditor, person interested in funds held as a fiduciary, lessee of a safe deposit box and bailor of property, at the address of such person as shown on the books of the bank. The notice shall be posted conspicuously on the premises of the bank and shall be given such publication as the commissioner may require. The bank shall send with each notice a statement of the amount shown on the books to be the claim of the depositor or creditor. The notice shall demand that property held by the bank as bailee or in a safe deposit box be withdrawn by the person entitled thereto and that claims of depositors and creditors, if the amount claimed differs from that stated in the notice to be due, be filed with the bank before a specified date not earlier than sixty days thereafter, in accordance with the procedure prescribed in the notice.

(c) As soon after approval as may be practicable, the

state bank shall resign all fiduciary positions and take such action as may be necessary to settle its fiduciary accounts.

(d) Safe deposit boxes, the contents of which have not been removed within thirty days after demand, shall be opened and the the contents dealt with in the manner provided for boxes upon which the payment of rental is in default. The sealed packages containing the contents and the certificate, together with any other unclaimed property held by the bank as bailee, and certified inventories thereof shall be transferred to the Commissioner, who shall retain them for six years unless sooner claimed by the person entitled to them. After six years the Commissioner shall sell or otherwise appropriately dispose of the property. The proceeds of any sale shall be transferred to the state treasurer as abandoned funds.

(e) The approval of an application for liquidation shall not impair any right of a depositor or creditor to payment in full and all lawful claims of creditors and depositors shall promptly be paid. The unearned portion of the rental of a safe deposit box shall be returned to the lessee.

(f) Any assets remaining after the discharge of all obligations shall be distributed to the stockholders in accordance with their respective interests. No such distribution shall be made before (i) all claims of depositors and creditors have been paid or, in the case of any disputed claim, the bank has transmitted to the Commissioner a sum adequate to meet any liability that may be judicially determined and (ii) any funds payable to a depositor or creditor and unclaimed have been transmitted to the Commissioner. Any unclaimed distribution to a stockholder or depositor shall be held until ninety days after the final distribution and then transmitted to the Commissioner. Such unclaimed funds shall be held by the Commissioner for six years and, unless sooner claimed by the person entitled thereto, shall be transferred to the treasury of the county, in which the bank is located. The county treasurer and his successors shall hold such money in trust for a period of six years, unless the same shall be sooner paid out to the beneficial owner, or owners, thereof, or a suit be instituted to recover such money, or a portion thereof. Any money remaining

in said fund six years after the same is paid into the treasury of the county, for the recovery of which no action is pending, shall be transferred to the general fund of the county and all rights of the former beneficial owners therein to recover the same shall be forever barred.

(3) If the Commissioner finds that the assets will be insufficient for the full discharge of all obligations, or that completion of the liquidation has been unduly delayed, he may take possession and complete the liquidation in the manner provided in this Code for involuntary liquidations.

(4) The Commissioner may require reports of the progress of liquidation. Whenever he is satisfied that the liquidation has been properly completed, he shall cancel the charter and enter an order of dissolution.

* * * * *

Internal Revenue Code of 1954:

SEC. 301. DISTRIBUTIONS OF PROPERTY.

(a) IN GENERAL.—Except as otherwise provided in this chapter, a distributions of property (as defined in section 317(a)) made by a corporation to a shareholder with respect to its stock shall be treated in the manner provided in subsection (c).

(c) AMOUNT TAXABLE.—In the case of a distribution to which subsection (a) applies—

(1) AMOUNT CONSTITUTING DIVIDEND.—
—That portion of the distribution which is a dividend (as defined in section 316) shall be included in gross income.

SEC. 302. DISTRIBUTIONS IN REDEMPTION OF STOCK.

(a) GENERAL RULE.—If a corporation redeems its stock (within the meaning of section 317 (b)), and if paragraph (1), (2), (3), or (4) of subsection (b) applies, such redemption shall be treated as a distribution in part or full payment in exchange for the stock.

(b) REDEMPTIONS TREATED AS EXCHANGES.
(1) REDEMPTIONS NOT EQUIVALENT TO

DIVIDENDS.—Subsection (a) shall apply if the redemption is not essentially equivalent to a dividend.

SEC. 316. DIVIDEND DEFINED.

(a) GENERAL RULE.—For purposes of this subtitle, the term "dividend" means any distribution of property made by a corporation to its shareholders—

(1) out of its earnings and profits accumulated after February 28, 1913, or

(2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of earnings and profits at the time the distribution was made.

Except as otherwise provided in this subtitle, every distribution is made out of earnings and profits to the extent thereof, and from the most recently accumulated earnings and profits. To the extent that any distribution is, under any provision of this subchapter, treated as a distribution of property to which section 301 applies, such distribution shall be treated as a distribution of property for purposes of this subsection.

SEC. 331. GAIN OR LOSS TO SHAREHOLDERS IN CORPORATE LIQUIDATIONS.

(a) General Rule.—

(1) Complete Liquidations. — Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock.

SEC. 354. EXCHANGES OF STOCK AND SECURITIES IN CERTAIN REORGANIZATIONS.

(a) GENERAL RULE.—

(1) IN GENERAL.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securi-

ties in such corporation or in another corporation a party to the reorganization.

(2) LIMITATION.—Paragraph (1) shall not apply if—

(A) the principal amount of any such securities received exceeds the principal amount of any such securities surrendered, or

(B) any such securities are received and no such securities surrendered, or

(b) EXCEPTION.—

(1) IN GENERAL.—Subsection (a) shall not apply to an exchange in pursuance of a plan or reorganization within the meaning of section 368 (a) (1) (D) unless—

(A) the corporation to which the assets are transferred acquires substantially all of the assets of the transferor of such assets; and

(B) the stock, securities, and other properties received by such transferor, as well as the other properties of such transferor, are distributed in pursuance of the plan of reorganization.

SEC. 356. RECEIPT OF ADDITIONAL CONSIDERATION.

(a) GAIN OR EXCHANGES.—

(1) RECOGNITION OF GAIN.—If—

(A) section 354 or 355 would apply to an exchange but for the fact that

(B) the property received in the exchange consists not only of property permitted by section 354 and 355 to be received without the recognition of gain but also of other property or money,

then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) TREATMENT AS DIVIDEND.—If an exchange is described in paragraph (1) but has the effect of the distribution of a dividend, then there shall be treated as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be treated as gain from the exchange of property.

(b) ADDITIONAL CONSIDERATION RECEIVED IN CERTAIN DISTRIBUTIONS.—If—

(1) section 355 would apply to a distribution but for the fact that

(2) the property received in the distribution consists not only of property permitted by section 355 to be received without the recognition of gain, but also of other property or money,

then an amount equal to the sum of such money and the fair market value of such other property shall be treated as a distribution of property to which section 301 applies.

SEC. 368. DEFINITIONS RELATING TO CORPORATE REORGANIZATIONS.

(a) REORGANIZATION.—

(1) IN GENERAL.—For purposes of parts I and II and this part, the term "reorganization" means—

(A) a statutory merger or consolidation;

(B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of stock of another corporation if, immediately after the acquisition, the acquiring corporation has control of such other corporation (whether or not such acquiring corporation had control immediately before the acquisition);

(C) the acquition by one corporation, in exchange solely for all or a part of its voting stock

(or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of substantially all of the properties of another corporation, but in determining whether the exchange is solely for stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded;

(D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356;

(E) a recapitalization; or

(F) a mere change in identity, form, or place of organization, however effected.

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In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 1215

R. A. BABCOCK AND NORMA L. BABCOCK, PETITIONERS

v.

V. LEE PHILLIPS

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

The issue presented by this tax case is whether the transfer of substantially all the operating assets of a state bank to a newly formed national bank, controlled by the stockholders of the state bank (principally petitioner), constituted a "D" reorganization within the meaning of 1954 Code § 368, so that the distribution of the state bank's accumulated earnings to its stockholders is taxable as a dividend under § 356(a)(2).

Petitioner[1] owned 800 of State Bank's 1,000 outstanding shares. In 1957 and 1958 the following plan

[1] Mrs. Babcock is a party only because joint returns were filed.

was carried out: Petitioner purchased the remaining 200 shares from State Bank's president and immediately resold 150 shares to five individuals. Petitioner and the five individuals formed a new national banking corporation and paid $250,000 cash to the National Bank, receiving in exchange all of its stock in the same proportions as their stock ownership in State Bank. State Bank's fiduciary assets (*i.e.*, its loans receivable, bonds, notes, bills and cash) amounting to approximately $3,800,000, were transferred to National Bank in consideration for the latter's assumption of the former's liabilities to depositors and others. State Bank retained ownership of the bank building, certain equipment and approximately $500,000 cash; it leased the building and equipment to National Bank rent free. State Bank then liquidated and distributed the cash and other retained assets to petitioner, who, having repurchased the 150 shares sold to the five individuals, was State Bank's sole stockholder. (Pet. 13–14.)

The net result of this series of steps was as follows: The banking business which had been operated by State Bank continued without interruption under a new corporate charter (National Bank) at the same location, with the same officers (except for State Bank's president), employees and stockholders, and with the same equipment. The shareholders of State Bank immediately before the transaction owned all the stock of National Bank immediately after the transaction (petitioner in fact owned 85 percent of each). Aside from the change in corporate charters, the only change of significance was that over $500,000

(mostly cash) of State Bank's accumulated corporate earnings had been paid to its shareholders. (Pet. 14–15.)

Petitioner reported the liquidating distributions received from State Bank in excess of his basis in its stock as capital gains ($83,450 for fiscal 1958 and $63,388 for fiscal 1959). The Commissioner determined that these gains were taxable as ordinary income under § 356(a). (Pet. 16.) The Commissioner's determination was upheld by the district court (R. 20).[2] The court of appeals affirmed (Pet. 12–18).

The decision below is correct. There is no conflict of decisions or other reason for review by this Court.

1. In general, if substantially all the assets of a corporation (here State Bank) are transferred to a new corporation (here National Bank) which is controlled by the transferor corporation or one or more of its stockholders, the transaction constitutes a "D" reorganization. 1954 Code §§ 368(a)(1)(D), 354(b) (App. *infra*, pp. 11–13). If the transferor corporation then liquidates and distributes retained assets (cash and other property) to its stockholders, this property constitutes "boot" and is taxed as a dividend to the extent of the earnings and profits, if it "has the effect of the distribution of a dividend." Code § 356(a)(2) (App. *infra*, p. 12).

The theory behind this treatment is as follows: State Bank could have been "converted into a national banking association" without the formation of a new corporate entity. 12 U.S.C. 35; see also 2

[2] "R." references are to the printed record in the court of appeals.

Colo. Rev. Stat., 1963 Ann., § 14–10–2 *et seq.* If State Bank had been "converted" into a national bank and had also distributed the cash and other assets while retaining its operating assets intact, the distributions would have been taxed to the stockholders as a dividend. Thus, when State Bank decided instead to transfer its operating assets to a new corporation (National Bank), which was essentially a continuation of State Bank, and also to distribute the cash and other assets to its stockholders, the distribution should result in taxable dividends, just as if the transfer from one corporation to the other had not taken place.

The Code accomplishes this result by taxing as a dividend property ("boot") distributed to shareholders incident to a reorganization. Petitioner argues, however, that even though the corporate banking business continued uninterrupted in the new corporate shell (National Bank), which was owned 100 percent by State Bank's shareholders, the instant transaction nevertheless does not constitute a reorganization and that he should be allowed to withdraw State Bank's undistributed profits—in the form of nearly $500,000 of cash, plus additional real estate and equipment—at the capital gains rate.[3]

(a) Notwithstanding that National Bank ended up owning substantially all the operating assets neces-

[3] If the transaction does not constitute a reorganization, 1954 Code § 331 dealing with complete liquidation (App., *infra*, p. 11) would apparently make petitioner's profit on the transaction a capital gain. If, on the other hand, the transaction is a reorganization § 331 is inapplicable. See *Commissioner v. Estate of Bedford*, 325 U.S. 283, 291.

sary to conduct the continuing banking business (R. 10–12, Pet. 14), petitioner contends (Pet. 6) that "substantially all of the assets" of State Bank were not transferred to National Bank, as required by Code § 354(b)(1)(A). He argues that State Bank did not transfer its approximately $3,800,000 of fiduciary assets to National Bank, but rather that State Bank "escrowed cash and securities aggregating $3,827,254.76 with National Bank in trust for the depositors," and that "[i]t was the State Bank depositors who * * * deposited their funds * * * in [*i.e.*, transferred their funds to] National Bank." The only way that State Bank could transfer its assets to the new bank under Colorado law was to transfer them to the new bank as trustee for the old bank's depositors. This method of effectuating the transfer of the old bank's business to the new bank was "no more than [an] intermediate procedural device utilized to enable the new corporation to acquire all the assets of the old one pursuant to a single reorganization plan"; such "[t]ransitory phases of an arrangement frequently are disregarded [under the corporate reorganization] sections of the revenue acts where they add nothing to the completed affair."[4] *Helvering* v. *Alabama Asphaltic Limestone Co.*, 315 U.S. 179, 184–185. Moreover, National Bank's assumption of State Bank's liability to depositors serves only to emphasize the continuity of the cor-

[4] Certainly, it was not the intent of Congress in enacting the reorganization and dividend provisions of the Code to accord the shareholders of, for example, reorganizing banks more favorable tax treatment than that accorded the stockholders of other corporations undergoing comparable reorganizations.

porate enterprise, and is incompatible with petitioner's contention that the business was "liquidated." See *Moffatt* v. *Commissioner*, 363 F. 2d 262 (C.A. 9), certiorari denied, April 24, 1967, No. 804, this Term; *Davant* v. *Commissioner*, 366 F. 2d 874 (C.A. 5), certiorari denied, April 24, 1967, No. 911, this Term; *Pridemark, Inc.* v. *Commissioner*, 345 F. 2d 35 (C.A. 4).[5]

(b) Petitioner also contends that even if substantially all the assets of State Bank were transferred to National Bank, the transaction did not qualify as a "D" reorganization because the stockholders purchased National Bank's stock for $250,000 rather than receiving it via a distribution from State Bank pursuant to the plan of reorganization. The courts, however, have long rejected such formalistic arguments and have held that when one corporation transfers its essential business enterprise to another corporation which is controlled by one or more of the transferor corporation's stockholders, the transaction constitutes a "D" reorganization, regardless of the form in which the transaction is cast. See, *e.g.*, *Lewis* v. *Commissioner*, 176 F. 2d 646 (C.A. 1); *Heller* v. *Commis-*

[5] Petitioner's reliance (Pet. 6) upon Rev. Proc. 66-34, 1966-34 Int. Rev. Bull. 22, is misplaced. As pointed out in our Brief in Opposition to Certiorari in *Moffatt* v. *Commissioner* (pp. 6-11), whether the "substantially all" requirement is satisfied is not to be determined by a mechanical application of any particular percentage test. Furthermore, that ruling states that it is not attempting to define the statutory terms but merely to announce the type of transactions which will "ordinarily" be given favorable advance rulings. Even if a percentage test were applied in this case, State Bank transferred approximately 90 percent of its assets to National Bank (R. 19).

sioner, 2 T.C. 371, affirmed, 147 F. 2d 376 (C.A. 9), certiorari denied, 325 U.S. 868; *Bard-Parker Co.* v. *Commissioner,* 218 F. 2d 52 (C.A. 2), certiorari denied, 349 U.S. 906; *Liddon* v. *Commissioner,* 230 F. 2d 304 (C.A. 6), certiorari denied, 352 U.S. 824; *Commissioner* v. *Morgan,* 288 F. 2d 676 (C.A. 3), certiorari denied, 368 U.S. 836; *Moffat* v. *Commissioner, supra; Davant* v. *Commissioner, supra.* Here, since the same persons owned all the stock of both State Bank and National Bank, it made no difference to them whether National Bank paid for State Bank's assets in part by issuing some of its own stock which was then distributed to State Bank's stockholders; this would merely have increased the number of shares of National Bank stock which they owned, but would not have effected any substantive change in their ownership. "To require the actual transfer of stock certificates where such a transfer would be a meaningless gesture would be to make the reorganization provisions optional with the taxpayer, a result which Congress clearly did not intend." *Davant* v. *Commissioner, supra,* p. 887. Accord: *Heller* v. *Commissioner, supra; Liddon* v. *Commissioner, supra; Commissioner* v. *Morgan, supra; Moffatt* v. *Commissioner, supra.*

Moreover, the result reached by the court of appeals prevents the use of the reorganization sections to escape taxation by converting into capital gains distributions which are in effect dividends out of accumulated earnings and profits, and is in accord with the announced objectives of Congress in enacting the corporate reorganization and related dividend provisions of the 1954 Code—namely, "to insure that

transactions which are in substance, although not in form; dividend distributions * * * are subject to tax at ordinary income rather than at capital gain rates." S. Rep. No. 1622, 83d Cong., 2d Sess., p. 42.[6]

2. Contrary to petitioner's contention (Pet. 7–8), neither the result reached by the lower court nor its reasoning is in conflict with any other decision. Petitioner relies primarily on *United States* v. *Arcade Co.*, 203 F. 2d 230 (C.A. 6), which is clearly distinguishable factually. In its later case of *Liddon* v. *Commissioner, supra,* the sixth Circuit, on facts very similar to those in the instant case, held the transaction to be a "D" reorganization and distinguished *Arcade* on grounds that are equally applicable here (230 F. 2d at 307).[7]

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[6] Contrary to petitioner's contention (Pet. 8–10), the decision of the court of appeals is not based upon a lack of business purpose for the transaction. The lower court merely volunteered its belief that, since it was unnecessary to create a new corporate entity and to liquidate the old corporation in order to convert the state bank into a national bank (see § 5154, Revised Statutes, as amended (12 U.S.C. § 35); 2 Colo. Rev. Stat., 1963 Ann., § 14–10–2 *et seq.*), the purpose of the transaction was to siphon off State Bank's unneeded accumulated earnings, and that for this reason the transaction should be closely scrutinized. In any event, if there was in fact a valid business reason behind the transaction, as seemingly urged by petitioner (Pet. 3–4, 8–10), this "tends to confirm, rather than contradict, a reorganization." *Grubbs* v. *Commissioner*, 39 T.C. 42, 51, and cases there cited.

[7] In *Liddon* the taxpayers (husband and wife) owned 80 percent of old corporation's stock; the 20 percent stockholder wanted to retire. Taxpayers organized a new corporation, purchased its stock for $25,000 cash, and had the new corporation purchase the old corporation's operating assets. The old corporation then redeemed the 20 percent stockholder's stock and

Two other cases cited by petitioner—*Commissioner* v. *Berghash*, 361 F. 2d 257 (C.A. 2), and *Gallagher* v. *Commissioner*, 39 T.C. 144—are clearly distinguishable because the courts held that the stockholders of the old corporation did not have 80 percent "control" of the new corporation. See Code § 368(c) (App. *infra*, p. 13). Here, on the other hand, the six stockholders of the old corporation owned all the stock of the new corporation and petitioner alone owned 85 percent of both corporations.

In *Pridemark, Inc.* v. *Commissioner*, 345 F. 2d 35 (C.A. 4), the court found that there was no plan to transfer the assets and business of the old corporation to any new corporation controlled by the taxpayers. Here, on the other hand, there is no question that the parties planned to and did transfer substantially all the operating assets of the State Bank to the National Bank which they had formed for that purpose and that the transaction "resulted in a reincarnation of the State Bank as National" with the State Bank's business continued by the National Bank "as a going concern" (Pet. 18).[8]

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liquidated, distributing more than $150,000 in cash and notes to the taxpayers. The Sixth Circuit held this transaction—which is very similar to the instant case—to be a "D" reorganization.

[8] *First National Bank in Walsenburg* v. *Commissioner*, decided October 28, 1965 (P-H Memo T.C., par. 65,286), is inapposite. That case involved the question whether the new corporation was liable as a transferee for the debts of the old corporation. The court, without ever reaching the question whether the transfer of the assets from the old to the new corporation constituted a reorganization, held that there was no transferee liability because the new corporation paid full and adequate consideration for the assets.

3. Petitioner in the instant case presents substantially the same arguments as were presented by the taxpayers in *Moffat* v. *Commissioner,* No. 804, this Term, *Reef Corporation* v. *Commissioner,* No. 1005, this Term, and *Davant* v. *Commissioner,* No. 911, this Term, in all of which cases the Court denied certiorari on April 24, 1967. The considerations which led this Court to deny review in those cases are equally applicable here, and call for the same result.

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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MAY 1967.

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 316. DIVIDEND DEFINED.

(a) *General Rule.*—For purposes of this subtitle, the term "dividend" means any distribution of property made by a corporation to its shareholders—

(1) out of its earnings and profits accumulated after February 28, 1913, or

(2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

Except as otherwise provided in this subtitle, every distribution is made out of earnings and profits to the extent thereof, and from the most recently accumulated earnings and profits. * * *

* * * * * *

SEC. 331. GAIN OR LOSS TO SHAREHOLDERS IN CORPORATE LIQUIDATIONS

(a) *General Rule.*—

(1) *Complete liquidations.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock.

* * * * * *

SEC. 354. EXCHANGES OF STOCK AND SECURITIES IN CERTAIN REORGANIZATIONS.

(a) *General Rule.*—

(1) *In general.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursu-

ance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

* * * * *

(b) *Exception.*—

(1) *In general.*—Subsection (a) shall not apply to an exchange in pursuance of a plan of reorganization within the meaning of section 368(a)(1)(D), unless—

(A) the corporation to which the assets are transferred acquires substantially all of the assets of the transferor of such assets; and

(B) the stock, securities, and other properties received by such transferor, as well as the other properties of such transferor, are distributed in pursuance of the plan of reorganization.

* * * * *

SEC. 356. RECEIPT OF ADDITIONAL CONSIDERATION.

(a) *Gain on Exchanges.*—

(1) *Recognition of gain.*—If—

(A) section 354 or 355 would apply to an exchange but for the fact that

(B) the property received in the exchange consists not only of property permitted by section 354 or 355 to be received without the recognition of gain but also of other property or money,

then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) *Treatment as dividend.*—If an exchange is described in paragraph (1) but has the effect of the distribution of a dividend, then there shall be treated as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and

profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be treated as gain from the exchange of property.

* * * * *

SEC. 368. DEFINITIONS RELATING TO CORPORATE REORGANIZATIONS.

(a) *Reorganization.*—

(1) *In general.*—For purposes of parts I and II and this part, the term "reorganization" means—

* * * * *

(D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356;

* * * * *

(F) a mere change in identity, form or place of organization, however effected.

* * * * *

(c) *Control.*—For purposes of part I (other than section 304), part II, and this part, the term "control" means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

U.S. GOVERNMENT PRINTING OFFICE: 1967